

IT 06-14

Tax Type: Income Tax

Issue: Books and Records Insufficient

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

ABC, INC.,

Taxpayer

**NO. 00-IT-0000
FEIN: 00-0000000
NOD: IL-1120
TAX YEARS: 1996, 97, 98, 99**

**Kenneth Galvin
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

APPEARANCES: Mr. Patrick Patricoski, Dreyer, Foote, Streit, Furgason & Slocum, appearing on behalf of ABC, Inc.; Mr. Sean Cullinan, appearing on behalf of The Department of Revenue of the State of Illinois.

SYNOPSIS:

The Illinois Department of Revenue (hereinafter the "Department") issued a Notice of Deficiency (hereinafter "NOD") to ABC Incorporated (hereinafter "taxpayer") on January 20, 2005. The basis of the NOD was the Department's determination that the taxpayer incorrectly carried forward a net loss deduction from tax year 1987 to tax years 1996, 1997, 1998 and 1999. The taxpayer filed a timely protest of the NOD and requested a hearing, which was held on April 13, 2006, with *John Doe*, an officer of ABC, Inc. testifying. Following submission of all evidence and a

careful review of the record, it is recommended that the NOD be finalized as issued. In support thereof, the following “Findings of Fact” and “Conclusions of Law” are made.

FINDINGS OF FACT:

1. The Department’s *prima facie* case, inclusive of all jurisdictional elements, was established by the Notice of Deficiency issued on January 20, 2005. The NOD, for tax years 1996, 1997, 1998 and 1999, assessed a statutory deficiency of \$12,594.40 plus interest of \$13,101.84. Tr. pp. 4-5; Dept. Ex. No. 1.
2. On July 25, 2005, the Department sent the Internal Revenue Service a “Request for Return/Information” requesting copies of taxpayer’s Form 1120 for March, 1984, March, 1985, March, 1986, and March, 1987. The Internal Revenue Service responded that there was no record of taxpayer filing returns for any of the years requested. Tr. p. 6; Dept. Ex. No. 3.
3. On January 26, 2006, the Department sent the Internal Revenue Service an “SC-16 Request for Information,” requesting a copy of taxpayer’s Form 1120 for 1988. The Internal Revenue Service responded that there was no record of taxpayer filing a 1988 Form 1120. Tr. pp. 5-6; Dept. Ex. No. 2.

CONCLUSIONS OF LAW:

In the instant case, the Department was unable to verify that a federal Form 1120 for 1987 had ever been filed by *ABC*, Inc. and accordingly, the Department disallowed the taxpayer’s operating loss carry-forward from 1987 to tax years 1996, 1997, 1998 and 1999. On July 25, 2005, the Department sent the Internal Revenue Service a “Request for Return/Information” requesting copies of taxpayer’s Form 1120 for March, 1984, March, 1985, March, 1986, and March, 1987.

The Internal Revenue Service responded that there was no record of taxpayer filing returns for the requested years. Tr. p. 6; Dept. Ex. No. 3.

John Doe is an officer of the corporation. In 1987, he was general manager of the corporation. Tr. pp. 9-10. Mr. *Doe* testified that to the best of his knowledge, the corporation filed a federal tax return for 1987 and that either Mr. *Doe* or his father signed the tax return. When asked if he recalled signing the return for 1987, Mr. *Doe* responded that he “couldn’t tell you who signed what.” Tr. pp. 10, 17. According to Mr. *Doe*, he never received a notice from the Internal Revenue Service that a 1987 return had not been filed. Tr. p. 11. At the evidentiary hearing, Mr. *Doe* presented a completed 1987 federal Form 1120 showing a net operating loss deduction for year ending March 31, 1988. The federal Form 1120 for year ending March 31, 1988, is dated July 27, 1993 and is not signed. Taxpayer’s Ex. No. 1. There is no indication that the return was filed with the Internal Revenue Service.

Pursuant to Illinois statute, the Notice of Deficiency is *prima facie* correct and is *prima facie* evidence of the correctness of the amount of tax due, as shown therein. 35 ILCS 5/904. In order to overcome this presumption of validity, the taxpayer must produce competent evidence identified with its books and records showing that the NOD is incorrect. Oral testimony is not sufficient to overcome the *prima facie* correctness of the Department’s determinations. A.R.Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826 (1st Dist. 1988).

Mr. *Doe*’s testimony that he could not tell if he or his father signed the 1987 federal Form 1120 and that the corporation never received a notice from the Internal Revenue Service that a 1987 federal Form 1120 had not been filed is not sufficient to overcome the Department’s *prima facie* case. The Department was unable to determine that a federal Form 1120 for 1984, 1985, 1986 1987 or 1988 had been filed by *ABC*. Dept. Ex. Nos. 3 and 4. The 1987 federal Form 1120 produced by

Mr. *Doe* at the evidentiary hearing, dated July 27, 1993, unsigned, and with no indication that the Form was ever filed with the Internal Revenue Service, is not competent evidence to show that the Form 1120 for 1987 was filed. Since there is no competent evidence that *ABC* filed a federal Form 1120 for 1987, the net loss for that year cannot be verified and cannot be carried forward to 1996, 1997, 1998 and 1999. The taxpayer has failed to rebut the Department's *prima facie* case.

In closing arguments, counsel for *ABC* asked for "some leniency" so that "some of the penalties and fines would be reduced in this instance." Tr. p. 22. One of the most important factors to be considered in making a determination to abate a penalty is the extent to which the taxpayer made a good faith effort to determine its proper tax liability. A taxpayer will be considered to have made a good faith effort to determine its proper tax liability if it exercised ordinary business care and prudence in doing so. 86 Ill.Adm.Code § 700.400. Based on the testimony and evidence presented at the hearing, I am unable to conclude that *ABC* "exercised ordinary business care and prudence" in carrying-forward an unverifiable federal loss from 1987 and "some leniency" is not warranted in this case.

WHEREFORE, for the reasons stated above, it is my recommendation that the Notice of Deficiency dated January 20, 2005 should be finalized as issued.

Date: July 27, 2006

Kenneth Galvin
Administrative Law Judge